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SUBJECT: THE ECONOMICS OF PIRACY (AND WHY IT'S NOT GOING AWAY)

¶1. Summary. Low risk, low investment, and exceptionally high returns are strong and consistent motives for distributors and retailers to start, and stay, in business in the optical disc piracy industry. Setting up shop to sell pirated discs involves dealing with both organized crime and local law enforcement, but is nevertheless considered a worthwhile profitable business, particularly for small business owners with few other opportunities.

Legitimate CD stores have reduced prices to try to compete with pirate shops, but price differences are still substantial and prospects are bleak. As long as margins remain high and other employment and business opportunities are seen as less remunerative, enforcement efforts are unlikely to put a permanent dent in the piracy business. End summary.

So you want to open a pirate CD stall

¶2. In a series of interviews, pirate retailers candidly explained their motivation for setting up their small businesses. (Note: Econoff is Thai-American and did not identify himself in interviews as an Embassy employee.) For young Thais with few prospects, a pirate CD shop is a low-cost means to begin a potentially highly profitable business. One retailer at pirate-infested Pantip Plaza told Econoff of her upbringing in a poor family, and said that her parents could not support her and that she could never pay for higher education. She claimed that she had very few options and getting involved in piracy was her best choice to make money. Capital costs for starting a pirate shop are relatively low and even her family's modest financial situation was sufficient to begin her small yet profitable shop. However, the money comes with risk as well; she told Econoff she is constantly worried about the police, and is always on the lookout, though had yet to be caught.

¶3. Nearly all retailers interviewed had no college education, and related that few other business opportunities were available to them. One retailer had a Business Administration degree from a well-known local university, but told Econoff that the financial return selling bootleg optical discs was far superior to other legitimate job offers that he received upon graduation.

¶4. Market entrance costs can be minimal. The City Law Enforcement Department (CLED), a branch of the Bangkok Metropolis Authority, controls operations on public streets and authorizes establishment of street stalls on about 300 public streets. All vendors must receive a license to do so directly from the CLED, but the city collects no application fee and charges no rent. Although officially cost-free to open a street stall, a common practice is for one person to acquire many licenses for the same street, then rent out stalls to other vendors who wish to open shops. Rental prices vary according to the frequency of shoppers of that particular street, anywhere from 100 baht (USD 2.50) per day on a less-trafficked street to 100,000 baht (USD 2500) for a prime location. This practice became illegal in 2005 and the CLED is making efforts to eliminate the practice. Like many enforcement agencies, however, the CLED admits it is making little progress in

cleaning up the illegal renting activities and it seems doubtful that these practices will stop any time soon. The Deputy Director General noted that organized crime often has a hand in these types of illegal rent operations, making enforcement all that more difficult.

15. Similar rental practices take place in private malls, though costs increase dramatically. Outlandishly high rent costs or down payments can be the norm in a popular mall, and only high-profit retailers, such as optical disc piracy retailers, can afford the space. Pirate retailers told Econoff that space was at such a premium that commonly many different retailers will share space and the cost of rent in an area meant for a single shop. Often, a shop will appear to be a single shop that sells different types of optical discs, but each person in that area is a separate retailer with their own products. They keep the profits of whatever they individually sell but split the cost of rent with the other retailers.

16. Though entrance costs can be low, other barriers await an aspiring pirate. A retailer must have connections in the supply-chain before being able to access the supply of pirated optical disc merchandise, according to enforcement authorities. Similar to the drug world, only a trusted person will be able to gain entry into the pirate world. New retailers are often sent on a wild goose chase for their first supply shipment, told to change locations over and over until the supplier is satisfied that law enforcement is not following. Even then, supplies and payments are kept separate. The organizations that run these operations are cautious about undercover agents and choose wisely whom they will trust.

#### Profits and Costs

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BANGKOK 00004978 002 OF 003

17. Extremely high profit margins for pirated optical disc sales are consistent incentives for the pirate industry. Pirated music CDs and DVDs usually sell on the street for 100 baht and software for 130 baht. According to a Royal Thai Police Colonel active in enforcement, the cost of making a single disc from a factory is between 10 to 15 baht, depending on the quantity produced. The wholesale price of a CD from the distributor typically ranges between 25 and 40 baht, depending on the quantity purchased by the individual retailer, and rarely exceeds 50 baht. (Note: current exchange rate is 38 baht/dollar.) The Motion Picture Association estimates that a sale of a retail pirated movie of a DVD-5 (4.7 GB) will bring in about a 50 percent profit; a DVD-9 (8.5 GB) will bring a 100 percent profit. DVD-9s sell for a price of 200 baht. Multiply those profit margins by the hundreds of thousands of discs produced annually, and the piracy business becomes a multi-million dollar industry that produces more than enough revenue to cover all other costs. Retailers consider the incredible amount of potential money to be made to be more than worth the risk of getting caught.

18. There are several other fixed costs aside from the costs of creating the actual disc. The deep involvement between organized crime, government, and police in the piracy business creates a continual need for bribery funds and bail money for jailed retailers. Front line police officers are constantly paid off to turn a blind eye to piracy activities and for tips on raids. Thousands of discs are also seized by enforcement authorities each year, resulting in losses for retailers of millions of baht. Recording industry sources say that criminal organizations keep thugs on the payroll for protection of their markets at the ground level. Retailers are usually spared these costs as the powers above them handle it. But even adding in these risks and external costs, the piracy business still pulls in enough money to continue to operate smoothly.

19. Incomes for shop employees are substantial, and retailers manage to keep risks relatively low. A common practice by retailers is to hire minors under 14 years old to run day-to-day business, retrieving and sending discs to customers. Police have little interest in arresting minors and courts have even less interest in

prosecuting. According to recording group Phonorights Thailand, minor employees are paid a relatively handsome salary of 6,000 to 10,000 baht (USD 160 to 260) per month.

Legitimate retailers compete, barely  
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¶10. Legitimate sales in the 4 billion baht (USD 106 million) music industry are down 40 percent this year, according to industry rep Phonorights Thailand. Phonorights gave three reasons for the precipitous decline. First is the recent economic downturn, leading consumers to choose to save money by buying cheaper, pirated music, or no music at all. Second, a new type of music customer has hit the market in recent years, with behavioral patterns that advocate piracy. The younger generation's main experience with accessing music is through pirated CDs and internet downloads and has little experience buying legitimate product. Finally, supply of pirated CDs is on the upswing owing to a surge of imported pirated CDs from China and other neighboring countries, such as Malaysia and Burma.

¶11. Thai music makes up between 60 to 70 percent of the music market in Thailand, but local industry is struggling against the effects of piracy. Grammy, the leading record label in Thailand, reported a loss this year for the first time in 20 years. To combat piracy, and facing mounting pressure from the government, Grammy dropped prices three years ago from 250 baht to 150 baht per disc. Company reps said the strategy succeeded the first year but customers quickly returned to the pirate market. Grammy responded by requesting artists to produce more albums per year and increase quality, which met limited success.

¶12. The international market has also been suffering recently. Rumors abound that international music retailer CD Warehouse is going out of business, and their general manager confirmed that sales were low and declining. He predicted that the entire legitimate music retail industry would be out of business within five years. He recalled that when international record labels cut prices from 400 baht to 250-300 baht several years ago to combat piracy, sales stayed stagnant. A recent survey by the MPA showed that, surprisingly, the primary reason Thais purchased pirated DVDs was to avoid the censorship present in legitimate product. Additionally, pirated discs for newly released movie titles are available on DVD much faster and in more sales locations than legitimate versions, often accessible the day after the movie is released in theatres. Pricing was surprisingly found to be the least important reason, though still a key motivator.

¶13. Comment: The recording, movie and software industries have long pushed Thai authorities for stronger enforcement actions to combat

BANGKOK 00004978 003 OF 003

the widespread piracy of their products. However, it seems increasingly clear that enforcement faces a long uphill battle against not only the forces of organized crime and public apathy, but the primal forces of the market. With low capital and production costs and high margins, pirate disc shops will continue to be an attractive small business opportunity. And while price and accessibility of pirated discs exceeds that of legitimate product, consumers show no signs of declining demand. End comment.  
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